

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

LIBERTY MUTUAL INSURANCE)
COMPANY AND SUBSIDIARIES,)
Plaintiff,)
v.) Cnsl. Cv. No. 1:05-cv-11048-RCL
UNITED STATES OF AMERICA,)
Defendant.)

LIBERTY MUTUAL FIRE INSURANCE)
COMPANY AND SUBSIDIARIES,)
Plaintiff,)
v.) Former Cv. No. 1:05-cv-11049-RCL
UNITED STATES OF AMERICA,)
Defendant.)

DECLARATION OF JAMES W. KRESS

I, James W. Kress, hereby declare as follows:

1. I have been employed in the Corporate Taxation Department of Liberty Mutual Insurance Company since 2003. My duties have included tax compliance issues, work on IRS audits, and assisting with financial statements. My current position is Senior Tax Manager.
 2. I have reviewed the tax files and Annual Statement records of Liberty Companies.

3. On or before September 15, 1991, Liberty Mutual filed a consolidated federal income tax return for the taxable year ended December 31, 1990, reporting a fully paid tax liability of \$46,400,348. A copy of the cover page of this return are included as Attachment Kress-1 to this Declaration.

4. The following property and casualty insurance companies, among other companies, were included as members in Liberty Mutual's taxable year 1990 consolidated return: Liberty Mutual; Liberty Insurance Corporation; and Liberty Northwest Insurance Corporation.

5. On or before September 15, 1991, Liberty Fire filed a consolidated federal income tax return for the taxable year ended December 31, 1990, reporting a paid tax liability of \$3,787,359. A copy of the cover page of this return are included as Attachment Kress-2 to this Declaration.

6. Liberty Mutual, Liberty Insurance Corporation and Liberty Fire were subject to a reinsurance pooling agreement under which their premiums and losses incurred, including such components as salvage and subrogation, were accounted on a pooling percentage basis. During the relevant years, the respective percentages under the pooling agreement were as follows:

Liberty Mutual	84%
Liberty Fire	10%
Liberty Insurance Corporation	6%

7. The Internal Revenue Service ("IRS") conducted an extensive examination of Liberty Mutual's and Liberty Fire's consolidated tax returns for the taxable year 1990 and proposed adjustments to premiums, losses incurred and other items to be distributed between the two returns according to the companies's pooling percentages.

8. At the conclusion of the examination, the IRS issued separate thirty-day letters with an accompanying Revenue Agent's Report in which it proposed adjustments to taxable income based on a number of issues.

9. On June 15, 1995, Liberty Companies protested the thirty-day letters and accompanying Revenue Agent's Reports to the Appeals Office of the IRS.

10. All issues for Liberty Mutual were settled except the issues reserved on the Form 870-AD executed at the close of the appeal. A copy of the first page of the Form 870-AD for Liberty Mutual is attached to this Declaration as Attachment Kress-3.

11. All issues for Liberty Fire were settled except the issues reserved on the Form 870-AD executed at the close of the appeal. A copy of the first page of the Form 870-AD for Liberty Fire is attached to this Declaration as Attachment Kress-4.

12. On their originally-filed tax returns for the taxable year 1990, Liberty Companies changed their methods of accounting to reflect discounted estimated salvage recoverable on all lines as required by the 1990 Act.

13. The Liberty Companies applied the transition rules of the 1990 Act with respect to December 31, 1989 discounted estimated salvage recoverable.

14. For Gross Lines on which Liberty Companies had not taken any estimated salvage into account on the 1989 Annual Statements, they included in income \$2,234,800 as the partial 26 U.S.C. § 481 adjustment. This amount is equal to one-quarter of 13 percent of \$68,763,074, the discounted estimated salvage on Gross Lines.

15. For Net Lines on which Liberty Companies had taken estimated salvage into account on the 1989 returns as a reduction of losses incurred, Liberty Companies claimed a Special Deduction on their originally-filed 1990 returns pursuant to section 11305(c)(3) of the 1990 Act in the amount of \$41,583,257. This amount is equal to one-quarter of 87 percent of \$191,187,388 of discounted estimated salvage recoverable on Net Lines.

16. On audit, the IRS subsequently changed this amount and the change was agreed to by Liberty Companies.

17. At the September 15, 1991, extended due date for the Liberty Companies' 1990 tax returns, insurance industry discussions with the IRS and Treasury concerning the double-counting problem and the IRS's position that the Special Deduction was an exclusive transition rule were still underway, and many expected future guidance from the IRS to result.

18. Accordingly, Liberty Companies included a statement with their 1990 tax returns stating that they could not then determine the full amount of estimated salvage recoverable and that they disagreed with the position of Rev. Proc. 91-48 that the 1990 Act could be ignored. Because future IRS guidance was expected, Liberty Companies specifically reserved the right to change the position taken on the tax returns, stating "Further clarification resulting from industry discussion with the Internal Revenue Service on these items may result in the taxpayer filing an amended return." A copy of this statement for Liberty Fire is attached to this Declaration as Attachment Kress-5.

19. On or before September 15, 1992, Liberty Companies filed their tax returns for tax year 1991.

20. In September 1993, during the course of the examination of their 1990 income tax returns, Liberty Companies filed with the IRS a request to convert its Net Lines into Gross Lines, effective for tax year 1990 as permitted by the regulations. A copy of the affirmative adjustment for Liberty Fire is attached to this Declaration as Attachment Kress-6.

21. In the request for affirmative adjustment Liberty Companies specifically stated that it did not claim the Special Deduction because, for tax purposes, they no longer had any Net Lines. In the request, Liberty Companies' asked that loss reserves be grossed up for estimated salvage recoverable on Net Lines. Under the terms of Rev. Proc. 92-77 as it applied to the change required by the 1990 Act, the grossed-up estimated salvage recoverable was subject to the Fresh Start applied to salvage as of December 31, 1989.

22. The affirmative adjustment also claimed revised amounts of discounted estimated salvage recoverable on Net Lines, corrected (consistent with the disclosure on the 1991 Annual Statement) to reflect information that was not available at the time the original returns for 1990 were filed. As corrected, the relevant year-end 1989 and 1990 discounted estimated salvage recoverable amounts of Liberty Companies' were as follows:

DISCOUNTED SALVAGE	<u>12/31/89</u>		<u>12/31/90</u>
	Net Lines	Gross Lines	Net Lines
Liberty Mutual Ins. Co.	180,819,158	61,886,767	190,901,955
Liberty Mutual Fire Ins. Co.	19,650,028	6,876,307	20,767,361
Liberty Companies total	200,469,186	68,763,074	211,669,316

23. The IRS examined the 1990 returns and affirmative adjustments of Liberty Companies. As a result of the audit, the IRS agrees to the amounts of discounted estimated salvage, including the corrected amounts of December 31, 1989 discounted estimated salvage on Net Lines.

24. The following amounts of salvage at December 31, 1989 are those agreed with the IRS agent:

12/31/89 SALVAGE	<u>Undiscounted</u>		<u>Discounted</u>	
	Net Lines	Gross Lines	Net Lines	Gross Lines
Liberty Mutual Ins. Co.	231,389,202	65,179,800	180,819,158	61,886,767
Liberty Mutual Fire Ins. Co.	25,126,347	7,242,200	19,650,028	6,876,307
Liberty Companies total	256,515,549	72,422,000	200,469,186	68,763,074

25. The IRS made an audit adjustment with respect to the transition treatment of December 31, 1989 discounted estimated salvage on Gross Lines which Liberty Companies had not taken into account before tax year 1990. The IRS adjusted Liberty Companies' income to require them to include in income the full amount of that salvage as a 26 U.S.C. § 481 adjustment in 1990, without permitting either the 87 percent exclusion or the four-year spread under the Fresh Start transition rule in section 11305(c)(2) of the 1990 Act.

26. Further, the IRS audit did not allow the gross-up of loss reserves under Rev. Proc. 92-77 and the regulations for discounted estimated salvage recoverable on Net Lines, as requested in the affirmative adjustment.

27. Instead, for the Net Lines, the IRS allowed a Special Deduction equal to 87 percent of the December 31, 1989 corrected discounted estimated salvage recoverable balance, spread ratably over four years beginning in 1990.

28. Because it was based on the corrected amount, the IRS audit allowed a Special Deduction for tax year 1990 that was \$2,882,028 more than the amount claimed on Liberty Companies' original 1990 tax returns.

29. These audit adjustments resulted in an increase in tax for 1990, which Liberty Companies paid in full.

30. Liberty Companies neither made, nor sought to make, any change in method to "remove estimated salvage recoverable" with respect to any accident year from unpaid losses. Liberty Companies made no change of accounting with respect to salvage in 1990 except to report estimated salvage on Gross Lines as required by the 1990 Act. Beginning in 1990 and consistently in all later years, in filing their original tax returns, amended returns, requests for adjustment and refund claims, Liberty Companies have never deviated from reporting losses incurred which reflected estimated salvage on both Net and Gross Lines.

31. On page 60 of the Revenue Agent's Report dated March 15, 1995, the Internal Revenue Service explained its basis for denying Liberty Companies a gross-up of their estimated salvage under Rev. Proc. 92-77 for the taxable year 1990, as follows:

"The government contends, pursuant to Treas. Reg. 1.832-4(f)(3)(iii), that any taxpayer that 'claims the special deduction is precluded from also claiming the section 481 adjustment . . .' The government also maintains that once a company has taken the special deduction any change in method of computing unpaid

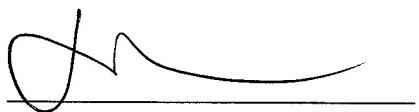
losses can only be done so with the consent of the Commissioner.
This position is based on section 4.04 of Rev. Proc. 92-77."

A copy of this page of the Revenue Agent's Report is attached to this Declaration as Attachment

Kress-7.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Executed on September 28, 2006.

A handwritten signature in black ink, appearing to read "J.W.Kress". It is written in a cursive style with a long horizontal line extending from the end of the signature.

James W. Kress

04-1543470

1120

Form
Department of the Treasury
Internal Revenue Service

A Consolidated return
B Personal holding co.
C Personal service corp. (as defined in sec. 1441-41 or - see instructions)
D Other wise, please print type.

U.S. Corporation Income Tax Return

For calendar year 1990 or tax year beginning _____, ending _____

► Instructions are separate. See page 1 for Paperwork Reduction Act Notice.

OMB No. 1345-0123

1990

Name **LIBERTY MUTUAL INSURANCE COMPANY**
CORPORATE TAXATION

Number, street, and room or suite no. (If a P.O. box, see page 2 of Instructions)

175 BERKELEY STREET POST OFFICE BOX 140

City or town, state, and ZIP code

BOSTON, MASSACHUSETTS

02117-0140

E Date incorporated

F Total assets (see Specific Instructions)

G

Increase
Decrease

See Instructions for limitations on deductions.)

Deductions

Tax and Payments

Please
Sign
Here.

Paid
Preparer's
Use Only

Preparer's
signature
Firm's name for
yours if self-employed
and address

H763-

OC1110-1 1.000

Check if a -		Use IRS label.	Name		Employer identification number	
<input checked="" type="checkbox"/> A Consolidated return			LIBERTY MUTUAL INSURANCE COMPANY		04-1543470	
<input type="checkbox"/> B Personal holding co.						
<input type="checkbox"/> C Personal service corp. (as defined in sec. 1441-41 or - see instructions)						
<input type="checkbox"/> D Other wise, please print type.						
G Check applicable boxes: (1) Initial return (2) Final return: (3) Change in address:						
1a or sales		b less returns			c Bal ► 1c	
2 Cost of goods sold (Schedule A, line 7)					2	
3 Gross profit (line 1c less line 2)					3	
4 Dividends (Schedule C, line 19)					4	
5 Interest					5	
6 Gross rents					6	
7 Gross royalties					7	
8 Capital gain net income (attach Schedule D (Form 1120))					8	
9 Net gain or (loss) from Form 4797, Part II, line 18 (attach Form 4797)					9	
10 Other income (see Instructions - attach schedule)					10	
11 Total Income - Add lines 3 through 10					11	
12 Compensation of officers (Schedule E, line 4)					12	
13a Salaries and wages		b Less jobs credit			13c	
14 Repairs					14	
15 Bad debts					15	
16 Rents					16	
17 Taxes					17	
18 Interest					18	
19 Contributions (see Instructions for 10% limitation)					19	
20 Depreciation (attach Form 4562)			20		21b	
21 Less depreciation claimed on Schedule A and elsewhere on return			21a		22	
22 Depletion					23	
23 Advertising					24	
24 Pension, profit-sharing, etc., plans					25	
25 Employee benefit programs					26	
26 Other deductions (attach schedule)					27	
27 Total deductions - Add lines 12 through 26					28	
28 Taxable income before net operating loss deduction and special deductions (line 11 less line 27)					259,742,636	
29 Less: a Net operating loss deduction (see Instructions)		Stmt. 1	29a	201,205,608	29c	
b Special deductions (Schedule C, line 20)			29b	27,192,837	30	
30 Taxable Income - Line 28 less line 29c					31	
31 Total tax (Schedule J, line 10)					31 46,400,348	
32 Payments: a 1989 overpayment credited to 1990		32a			32h 70,064,688	
b 1990 estimated tax payments		32b	67,064,688			
c Less 1990 refund applied for on Form 4466		32c				
d Tax deposited with Form 7004			32d	67,064,688		
e Credit from regulated investment companies (attach Form 2439)			32e	3,000,000		
f Credit for Federal tax on fuels (attach Form 4136). See Instructions			32f			
g Enter any penalty for underpayment of estimated tax - Check if Form 2220 is attached			32g			
33 Enter any penalty for underpayment of estimated tax - Check if Form 2220 is attached					33	
34 Tax due - If the total of lines 31 and 33 is larger than line 32h, enter amount owed					34	
35 Overpayment - If line 32h is larger than the total of lines 31 and 33, enter amount overpaid					35 23,664,340	
36 Enter amount of line 35 you want Credited to 1991 estimated tax ►			10,000,000	Refunded ►	36 13,664,340	
Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.						Date 09/13/91
Signature of officer G.H.DOLAN						Title ASST. COMPTROLLER
Preparer's signature		JOHN F. DUFF		Date 09/13/91	Check if self-employed	Preparer's social security no. 121-36-4177
Firm's name for yours if self-employed and address		KPMG PEAT MARWICK ONE BOSTON PLACE, BOSTON MA		E.I. No. 13-5565207	ZIP code 02108	

LIB - 000782

LIBERTY MUTUAL FIRE INSURANCE COMPANY

Imfic V1.07

Form 1120-PC

U.S. Property and Casualty Insurance Company
Income Tax Return

OMB No. 1545-1027

Department of the Treasury
Internal Revenue Service

For calendar year 1990, or tax year beginning _____ and ending _____

► See separate instructions

1990

Please type	Name	A Employer identification number
	LIBERTY MUTUAL FIRE INSURANCE COMPANY ATTN: TAX ACCOUNTING DEPT.	04-1924000

Number and street, and room or suite no. (if a P.O. box, see page 3 of Instructions)
175 BERKELEY STREETCity or town, state, and ZIP code
BOSTON 02117B Date incorporated
07/08/32C Check if this is a consolidated return ►

D Check applicable boxes: (1) Final return (2) Change in address (3) Amended return

E Check applicable box if an election has been made under section(s) ► (1) 953(c)(3)(C) (2) 953(d)

F Check box for kind of company: (1) Mutual (2) Stock

1	-4,836,330.
2	
3	
a	Enter your share of the \$50,000 amount and \$25,000 amount (in that order) in each taxable income bracket: (i) 50,000. (ii) 25,000. 11,750.
b	Enter your share of the additional tax (not to exceed \$11,750) ► 11,750.
4	NONE
5	
6	
7	Tax credits:
a	Foreign tax credit (attach Form 1118) 7a
b	Other credits (see instructions) 7b
c	General business credit. Check if from: <input type="checkbox"/> Form 3800 <input type="checkbox"/> Form 3468 <input type="checkbox"/> Form 5884 <input type="checkbox"/> Form 6478 <input type="checkbox"/> Form 6765 <input type="checkbox"/> Form 8586 7c
d	Credit for prior year minimum tax (attach Form 8801) 7d
e	Total credits (add lines 7a through 7d) 7e
8	
9	
10	Balance of tax (line 6 less line 7e) 8
11a	Foreign corporations - Tax on income not connected with U.S. business 9
11b	Recapture taxes. Check if from: <input type="checkbox"/> Form 4255 <input type="checkbox"/> Form 8611 10
11c	Alternative minimum tax (attach Form 4626) (See instructions) 11a 3,725,082.
11d	Environmental tax (attach Form 4626) 11b 61,689.
12	Personal holding company tax (attach Schedule PH (Form 1120)) 11c
13	Total tax (add lines 8 through 12) 11d 3,787,359.
14a	1989 overpayment allowed as a credit 12
14b	
14c	1,350,000. 13
14d	
e	1990 refund applied for on Form 4466 14e
f	Enter the total of lines 14a through 14c less line 14e 14f 1,721,007.
g	Tax deposited with Form 7004 14g 3,000,000.
h	Credit by reciprocal for tax paid by attorney-in-fact under section 835(d) 14h 12,938.
i	Other credits and payments 14i 14j 4,733,945.
j	Total credits and payments (add lines 14f through 14i) 14k
15	Enter any PENALTY for underpayment of estimated tax - Check ► <input type="checkbox"/> if Form 2220 is attached 14l
16	TAX DUE - If the total of lines 13 and 15 is larger than line 14j, enter AMOUNT OWED 14m
17	OVERPAYMENT - If line 14j is larger than the total of lines 13 and 15, enter AMOUNT OVERPAID 14n 946,586.
18	Enter amount of line 17 you want Credited to 1991 estimated tax ► 14o 946,586. Refunded ► 14p

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Please Sign Here	G.H. DOLAN	Date 09/13/91	Title ASST. COMPTROLLER
Paid Preparer's Use Only	Preparer's signature ► John F. Duff	Date 09/13/91	Preparer's social security no. 121-36-4177
		Check if self-employed ► <input type="checkbox"/>	E.I. No. ► 13-5565207
	Firm's name (or yours if self-employed) and address ► KPMG PEAT MARWICK ONE BOSTON PLACE, BOSTON, MA	ZIP code ► 02108	Form 1120-PC (1990)

H763

► Notice, see page 1 of the instructions.

As Originally Filed

LIB - 000950

1/

Form 870-AD
(rev. 04/92)

Department of the Treasury-Internal Revenue Service

**Offer to Waive Restrictions on Assessment and Collection
of Tax Deficiency and to Accept Overassessment**

Symbols:
AP:NE:RWD

Name of Taxpayer:
Liberty Mutual Insurance Company and Affiliated Subsidiaries

SSN or EIN:
04-1543470

Under the provisions of section 6213(d) of the Internal Revenue Code of 1986 (the Code), or corresponding provisions of prior internal revenue laws, the undersigned offers to waive the restrictions provided in section 6213(a) of the Code or corresponding provisions of prior internal revenue laws, and to consent to the assessment and collection of the following deficiencies and additions to tax, if any, with interest as provided by law. The undersigned offers also to accept the following overassessments, if any, as correct. Any waiver or acceptance of an overassessment is subject to any terms and conditions stated below and on the reverse side of this form.

**Deficiencies (Overassessments)
and Additions to Tax**

Year Ended	Kind of Tax	Tax				
December 31, 1985	Income	\$(202,435)				
December 31, 1986	Income	\$(1,225,322)				
December 31, 1987	Income	\$(1,035,285)				
December 31, 1988	Income	\$ 0				
December 31, 1989	Income	\$(2,617,590)				
December 31, 1990	Income	\$40,415,252				

This offer must be accepted for the Commissioner of Internal Revenue and will take effect on the date it is accepted. Unless and until it is accepted, it will have no force or effect.

If this offer is accepted, the case will not be reopened by the Commissioner unless there was:

- fraud, malfeasance, concealment or misrepresentation of a material fact
- an important mistake in mathematical calculation
- a deficiency or overassessment resulting from adjustments made under Subchapters C and D of Chapter 63 concerning the tax treatment of partnership and subchapter S items determined at the partnership and corporate level
- an excessive tentative allowance of a carryback provided by law

No claim for refund or credit will be filed or prosecuted by the taxpayer for the years stated on this form, other than for amounts attributed to carrybacks provided by law.

The proper filing of this offer, when accepted, will expedite assessment and billing (or overassessment, credit or refund) by adjusting the tax liability. This offer, when executed and timely submitted, will be considered a claim for refund for the above overassessment(s), if any.

Subject to ADDITIONAL PROVISIONS on the reverse side of this form.

Signature of Taxpayer:

Date:

Signature of Taxpayer:

Date:

Signature of Taxpayer's Representative:

Date:

Corporate Name: Liberty Mutual Insurance Company and Affiliated Subsidiaries

Date:

By Corporate Officer:

Title: Vice President

Date:

6/18/02

For
Internal
Revenue
Use Only

Date Accepted for Commissioner:
7/2/2002

Signature:

Robert W. Donovan

Office:
Boston, MA

Title:

Appeals Team Case Leader

(See reverse side for signature instructions.)

LIB - 000317

Form 870-AD
(rev. 04/92)

Department of the Treasury-Internal Revenue Service

**Offer to Waive Restrictions on Assessment and Collection
of Tax Deficiency and to Accept Overassessment**

Symbols:
*NE:RWD

Name of Taxpayer:
Liberty Mutual Fire Insurance Company

SSN or EIN :
04-1924000

Under the provisions of section 6213(d) of the Internal Revenue code of 1986 (the Code), or corresponding provisions of prior internal revenue laws, the undersigned offers to waive the restrictions provided in section 6213(a) of the Code or corresponding provisions of prior internal revenue laws, and to consent to the assessment and collection of the following deficiencies and additions to tax, if any, in interest as provided by law. The undersigned offers also to accept the following overassessments, if any, as correct. Any waiver or acceptance of an overassessment is subject to any terms and conditions stated below and on the reverse side of this form.

**Deficiencies (Overassessments)
and Additions to Tax**

Year Ended	Kind of Tax	Tax	APR 23 2002	BOSTON	MA	CHICAGO
December 31, 1987	Income	\$(116,569)				
December 31, 1988	Income	\$-0-				
December 31, 1989	Income	\$(341,363)				
December 31, 1990	Income	\$3,030,440				

This offer must be accepted for the Commissioner of Internal Revenue and will take effect on the date it is accepted. Unless and until it is accepted, it will have no force or effect.

If this offer is accepted, the case will not be reopened by the Commissioner unless there was:

- *fraud, malfeasance, concealment or misrepresentation of a material fact*
- *an important mistake in mathematical calculation*
- *a deficiency or overassessment resulting from adjustments made under Subchapters C and D of Chapter 63 concerning the tax treatment of partnership and subchapter S items determined at the partnership and corporate level*
- *an excessive tentative allowance of a carryback provided by law*

No claim for refund or credit will be filed or prosecuted by the taxpayer for the years stated on this form, other than for amounts attributed to carrybacks provided by law.

The proper filing of this offer, when accepted, will expedite assessment and billing (or overassessment, credit or refund) by adjusting the tax liability. This offer, when executed and timely submitted, will be considered a claim for refund for the above overassessment(s), if any.

Subject to ADDITIONAL PROVISIONS on the reverse side of this form.

Signature of Taxpayer:	Date:
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Signature of Taxpayer:	Date:
------------------------	-------

Signature of Taxpayer's Representative:	Date:
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Corporate Name: Liberty Mutual Fire Insurance Company	Date:
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Corporate Officer: <i>John J. O'Brien</i>	Title: <i>Vice President</i>	Date: <i>7/19/02</i>
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For Internal Revenue Use Only	Date Accepted for Commissioner: <i>7/23/02</i>	Signature: <i>Robert W. Donovan</i>
	Office: <i>Boston, MA</i>	Title: Appeals Team Case Leader

(See reverse side for signature instructions)

1990 TR

Liberty Mutual Fire Insurance Company (04-1924000)

SECTION 6662 DISCLOSURE

The Revenue Reconciliation Act of 1990 ("the Act") provides that property and casualty insurance companies are required to reduce their losses incurred by discounted estimated salvage recoverable beginning in 1990. Section 11305(c)(3) of the Act allows companies that previously anticipated salvage recoverable to deduct 87 percent of the discounted amount of salvage recoverable previously taken into account prior to 1990. This deduction is to be taken into account over four taxable years beginning in 1990.

The Internal Revenue Service recently issued Revenue Procedure 91-48, the purpose of which was to provide guidance with respect to the discounting of estimated salvage recoverable, the Section 481 adjustment under Section 11305(c)(2) of the Act, the special deduction under Section 11305(c)(3) of the Act, the special rule for over estimates under Section 11305(c)(4) of the Act and changes in estimates of salvage recoverable.

The taxpayer is not following the provisions of Revenue Procedure 91-48 in this tax return with respect to the mutually exclusive rule contained in Sections 8 and 9 of the Revenue Procedure. The taxpayer feels that Revenue Procedure 91-48 provides for an improper interpretation of the tax law with respect to this item. Further clarification resulting from industry discussions with the Internal Revenue Service on these items may result in the taxpayer filing an amended tax return.

Also, the taxpayer understands that if an election is not made under Section 11 of the Revenue Procedure with respect to the "deferral of an accounting change", then the taxpayer who claims the special deduction will be forever precluded from making an election to defer the accounting change. The taxpayer intends to make a protective election under Section 11 of the Revenue Procedure, pending clarification of Sections 8 and 9 of the Revenue Procedure.

While the next-to-last sentence of Revenue Procedure 91-48, Section 4.02, seems to suggest that an insurer claiming the 87 percent transitional deduction under Section 11305(c)(3) of the Act has to ignore the discounted year-end 1989 salvage and subrogation recoverable in the computation of "losses incurred" for 1990 under Code Section 832(b)(5)(A), the taxpayer finds nothing in the wording of Code Section 832 or 1990 Act Section 11305 that would require such a result. The taxpayer believes that the 87 percent transitional deduction was

Section 6662 Disclosure Continued 04-1924000

intended to provide a "level playing field" between insurers that were anticipating (and thus paying taxes on) salvage and subrogation before 1990 and those that were not. Accordingly, it is taxpayer's position that the benefit of the 87 percent transitional deduction is available in addition to the benefit of including prior-year-end salvage and subrogation in the computation under Code Section 832(b)(5)(A).

While the amount of salvage and subrogation recoverable was not shown explicitly on the taxpayer's 1989 annual statement, the methods used by the taxpayer in computing its reserves for unpaid losses on its 1989 annual statement had the effect of implicitly anticipating salvage and subrogation recoverable. The taxpayer is prepared to establish to the satisfaction of the IRS District Director that this result did occur in the preparation of its 1989 annual statement, and to show the specific amounts of anticipated salvage and subrogation by line of insurance for each accident year.

The taxpayer has not filed a statement with a state regulatory authority as described in proposed regulation Section 1.832-4(e). As the taxpayer reads that portion of the proposed regulation, filing such a statement with a state regulatory authority is intended to be one method, but not necessarily the only method, by which an insurer may establish that it took estimated salvage and subrogation recoverable into account. Furthermore, taxpayer finds nothing in Section 11305(c)(3) of the Act to indicate that submitting such a statement to a state regulatory authority is a necessary condition for claiming the 87 percent transitional deduction.

At this time, the taxpayer has not quantified the tax effects of these issues.

1990 Tax Return

Liberty Mutual Fire Insurance Company (04-1924000)

**ELECTION FOR TAXPAYERS CLAIMING SPECIAL DEDUCTION THAT ALSO
TOOK SALVAGE INTO ACCOUNT IN DETERMINING UNDISCOUNTED
UNPAID LOSSES FOR THE 1990 ACCIDENT YEAR PURSUANT TO
SECTION 11 OF REV. PROC. 91-48**

The taxpayer feels that Revenue Procedure 91-48 contains conditions which have no basis in law and that improper interpretations of the law have been made, however, we feel it necessary, in the event that Rev. Proc. 91-48 is found to be correct, to make a protective election under Section 11. The taxpayer therefore makes an election under Sections 11 of Revenue Procedure 91-48, and agrees to apply the special rule for overestimates in section 11305(c)(4) of the 1990 Act.

The taxpayer is unable to determine the amount of estimated salvage recoverable taken into account in determining the undiscounted unpaid losses for the 1990 accident year due to the mutually exclusive rules contained in Sections 8 and 9 of Revenue Procedure 91-48. Further clarification resulting from industry discussions with the Internal Revenue Service on these items may result in the taxpayer filing an amended tax return

Affirmative Adjustment under Rev-Proc. 92-77

(1) Rev. Proc. 92-77 allows taxpayers a choice between effectively taking the special deduction for salvage and subrogation in one year or spreading it over four years. However, it was not possible for taxpayers to be aware of this option when their 1990 and 1991 tax returns were filed.

(2) By eliminating the special deduction that was taken in 1990 and 991, Liberty Mutual Insurance Group will be in compliance with the mutually exclusive rule. The mutually exclusive rule says that taxpayers claiming the fresh start cannot also claim the special deduction. We hereby elect to eliminate the special deduction.. The worksheets attached summarize the affect of eliminating the special deduction.

In order to implement the one year deduction option allowed under Rev-Proc 92-77, we request an affirmative issue on audit.

AFFIRMATIVE ADJUSTMENT

	As Filed	1990	1991	1992	1993	Total
Gross Reserves						
Less: 481 Inclusion						
Decrease in Income						
Deduction for Net Reserves						
As adjusted						
Gross reserves						
Less: 481 inclusion						
Decrease in Income						
Deduction for Net Reserves						
Change						
Consolidated change						
Fire Company change						

Reconciliation of Original to Adjusted							Net Annual (Increase) or Decrease
@12/31/89 Undiscounted	Discounted	Gross Reserves	Net Reserves	Reserve Forgiveness	Annual 481 Inclusion	Annual 481 Deduction	
Original Estimate of S & S	\$309,668,095	\$255,981,560	\$68,783,075	\$187,218,485	\$59,823,875	\$2,234,800	\$40,720,020
Adjustments							
Auto Phys Damage	\$84,340						
Auto Liability	\$43,136						
Recast Dlr Voluntary @ 12/89	\$247,123,000						
Mass Car	\$26,574,749						
NCCI Pool	\$49,860,245						
W/C Liberty N/wes	\$5,252,079						
	<u>\$328,937,549</u>	<u>\$269,232,261</u>	<u>\$269,232,261</u>	<u>\$0</u>	<u>\$234,232,067</u>	<u>\$8,750,048</u>	<u>\$0</u>

**Salvage and Subrogation Recoverable on Paid and Unpaid
Losses at December 31, 1988**

Line of Insurance	Recoverable \$ & Actuarial Estimate @ 12/31/89			Discounted Reserves			A/S Reserves Grossed-Up			A/S Reserves Netted		
	of Recoverable Books of Compa	Books of Compa	Forgiveness	Annual 481 Reserve	Annual Addition	Reserve	Annual 481 Reserve	Annual Addition	Reserve	Deduction over Years	(Increase) or Decrease in Taxable Income	
Undiscounted	@ 12/31/89	@ 12/31/89	87%	87%	87%	87%	87%	87%	87%	87%	87%	
Auto Phy Dama	91,026,877	86,469,745	86,469,745	0	75,228,878	2,810,267	0	0	0	0	0	
Auto Liability	23,178,348	20,356,071	20,356,071	0	17,709,782	661,572	0	0	0	0	(661,572)	
General Liability	5,811,000	4,397,468	4,397,468	0	3,825,795	142,918	0	0	0	0	(142,918)	
Workers Comp	189,408,324	140,860,623	140,860,623	0	122,548,742	4,577,970	0	0	0	0	(4,577,970)	
Fidelity & Burg	620,000	592,715	592,715	0	515,862	19,263	0	0	0	0	(19,263)	
Comm Multi Peri	15,783,000	13,617,960	13,617,960	0	11,847,626	442,584	0	0	0	0	(442,584)	
Fire & Allied	3,111,000	2,837,680	2,837,680	0	2,555,782	85,475	0	0	0	0	(85,475)	
Total	328,937,549	269,232,261	269,232,261	0	234,232,067	8,760,048	0	0	0	0	(8,760,048)	
Adjustment to 1990 Income							(8,750,048)					
Adjustment to 1991 Income							(8,750,048)					
Adjustment to 1992 Income							(8,750,048)					
Adjustment to 1993 Income							(8,750,048)					
Total							\$269,232,261					
Net Effect							\$234,232,067					

(8,750,048)
(8,750,048)
(8,750,048)
(8,750,048)
(35,000,194)

09/13/93

Federal Income Taxes 1990 OBRA

Salvage and Subrogation Recoverable on Paid and Unpaid
Losses at December 31, 1989

Line of Insurance Auto Physical Dam	Actuarial Estimate of Recoverable Books of Company @ 12/31/89	Undiscounted Reserves			Discounted Reserves		
		Recognized on Books of Company @ 12/31/89	Not Recognized on Books of Company @ 12/31/89	Discount Factor @ 12/31/89	Actuarial Estimate of Recoverable Books of Company @ 12/31/89	Not Recognized on Books of Company @ 12/31/89	
AY+0	59,222,396	47,118,517	12,103,879	95.4631%	58,535,535	44,980,797	11,554,738
AY+1	20,993,337	16,702,717	4,290,820	92.8552%	19,493,405	15,509,341	3,984,064
AY+2	7,113,825	5,659,901	1,453,924	96.5834%	6,870,774	5,466,525	1,404,249
AY+3	2,296,280	1,826,966	469,314	96.5834%	2,217,825	1,764,546	453,279
AY+4	753,021	753,021	96.5834%	727,293	0	727,293	
AY+5	285,007	285,007	96.5834%	275,289	0	275,269	
AY+6	116,008	116,008	96.5834%	112,044	0	112,044	
AY+7	51,003	51,003	96.5834%	49,260	0	49,260	
AY+8	195,000	195,000	96.5834%	188,338	0	188,338	
AY+9	0	0	0	0	0	0	
AY+10	0	0	0	0	0	0	
AY+11	0	0	0	0	0	0	
AY+12	0	0	0	0	0	0	
AY+13	0	0	0	0	0	0	
AY+14	0	0	0	0	0	0	
AY+15	0	0	0	0	0	0	
Total	91,025,877	72,422,000	19,717,776		86,469,745	67,721,209	18,748,536

Line of Insurance Auto Liability	Actuarial Estimate of Recoverable Books of Company @ 12/31/89	Undiscounted Reserves			Discounted Reserves		
		Recognized on Books of Company @ 12/31/89	Not Recognized on Books of Company @ 12/31/89	Discount Factor @ 12/31/89	Actuarial Estimate of Recoverable Books of Company @ 12/31/89	Not Recognized on Books of Company @ 12/31/89	
AY+0	8,865,207	8,865,207	87,9621%	7,798,022	0	7,798,022	
AY+1	7,868,418	7,868,418	87,7895%	6,907,645	0	6,907,645	
AY+2	3,208,475	3,208,475	88,3812%	2,833,921	0	2,833,921	
AY+3	1,406,222	1,406,222	87,6600%	1,232,694	0	1,232,694	
AY+4	788,400	788,400	86,6075%	682,814	0	682,814	
AY+5	216,902	216,902	84,3689%	182,998	0	182,998	
AY+6	372,567	372,567	83,0789%	309,525	0	309,525	
AY+7	121,716	121,716	83,1890%	101,254	0	101,254	
AY+8	63,158	63,158	86,6551%	54,730	0	54,730	
AY+9	269,283	269,283	93,7561%	252,469	0	252,469	
AY+10	0	0	93,7561%	0	0	0	
AY+11	0	0	93,7561%	0	0	0	
AY+12	0	0	93,7561%	0	0	0	
AY+13	0	0	93,7561%	0	0	0	
AY+14	0	0	93,7561%	0	0	0	
AY+15	0	0	93,7561%	0	0	0	
Total	23,178,348	0	23,178,348		20,356,071	0	20,356,071

Line of Insurance General Liability	Undiscounted Reserves			Discounted Reserves		
	Actuarial Estimate of Recoverable Books of Compa @ 12/31/89	Recognized on Books of Compa @ 12/31/89	Not Recognized Books of Compa @ 12/31/89	Discount Factor @ 12/31/89	Actuarial Estimate of Recoverable Books of Compa @ 12/31/89	Recognized on Books of Company @ 12/31/89
AY +0	1,109,000	1,109,000	74,5408%	74,5408%	826,657	0
AY +1	850,000	850,000	76,4051%	76,4051%	649,443	0
AY +2	562,000	562,000	78,3308%	78,3308%	440,219	0
AY +3	1,366,000	1,366,000	77,3635%	77,3635%	1,056,785	0
AY +4	888,000	888,000	76,2351%	76,2351%	676,968	0
AY +5	52,000	52,000	73,9097%	73,9097%	38,433	0
AY +6	112,000	112,000	72,9563%	72,9563%	81,711	0
AY +7	0	0	71,2185%	71,2185%	0	0
AY +8	872,000	872,000	71,9322%	71,9322%	627,249	0
AY +9	0	0	74,9278%	74,9278%	0	0
AY +10	0	0	85,7395%	85,7395%	0	0
AY +11	0	0	85,7395%	85,7395%	0	0
AY +12	0	0	85,7395%	85,7395%	0	0
AY +13	0	0	85,7395%	85,7395%	0	0
AY +14	0	0	85,7395%	85,7395%	0	0
AY +15	0	0	85,7395%	85,7395%	0	0
Total	5,811,000	0	5,811,000	4,397,466	0	4,397,466
Undiscounted Reserves						
Line of Insurance	Actuarial Estimate of Recoverable Books of Compa @ 12/31/89	Recognized on Books of Compa @ 12/31/89	Discount Factor @ 12/31/89	Actuarial Estimate of Recoverable Books of Compa @ 12/31/89	Recognized on Books of Company @ 12/31/89	Discounted Reserves
Workers Comp	@ 12/31/89	@ 12/31/89	@ 12/31/89	@ 12/31/89	@ 12/31/89	
AY +0	51,982,726	51,982,726	79,2331%	41,187,525	0	41,187,525
AY +1	49,548,999	49,548,999	75,0361%	37,179,636	0	37,179,636
AY +2	42,931,413	42,931,413	72,8193%	31,262,354	0	31,262,354
AY +3	22,284,827	22,284,827	69,9799%	15,594,909	0	15,594,909
AY +4	10,412,422	10,412,422	68,6137%	7,144,348	0	7,144,348
AY +5	4,148,682	4,148,682	67,1574%	2,786,147	0	2,786,147
AY +6	2,548,233	2,548,233	67,9048%	1,730,373	0	1,730,373
AY +7	1,237,922	1,237,922	68,6515%	849,852	0	849,852
AY +8	627,852	627,852	69,6203%	437,112	0	437,112
AY +9	3,685,248	3,685,248	72,9494%	2,688,366	0	2,688,366
AY +10	0	0	85,2792%	0	0	0
AY +11	0	0	85,2792%	0	0	0
AY +12	0	0	85,2792%	0	0	0
AY +13	0	0	85,2792%	0	0	0
AY +14	0	0	85,2792%	0	0	0
AY +15	0	0	85,2792%	0	0	0
Total	189,408,324	0	189,408,324	140,860,623	0	140,860,623

Line of Insurance Fidelity & Burglary	Actuarial Estimate of Recoverable Books of Company @ 12/31/89	Undiscounted Reserves			Discounted Reserves		
		Recognized on Books of Company @ 12/31/89	Not Recognized on Books of Company @ 12/31/89	Discount Factor @ 12/31/89	Actuarial Estimate of Recoverable Books of Company @ 12/31/89	Recognized on Books of Company @ 12/31/89	Not Recognized on Books of Company @ 12/31/89
AY+0	69,000	69,000	83.9633%	64.828	64,828	0	64,828
AY+1	115,000	115,000	92.8562%	106,783	106,783	0	106,783
AY+2	85,000	85,000	96.5834%	82,096	82,096	0	82,096
AY+3	48,000	48,000	96.5834%	46,360	46,360	0	46,360
AY+4	190,000	190,000	96.5834%	183,508	183,508	0	183,508
AY+5	39,000	39,000	96.5834%	37,668	37,668	0	37,668
AY+6	3,000	3,000	96.5834%	2,888	2,888	0	2,888
AY+7	8,000	8,000	96.5834%	8,693	8,693	0	8,693
AY+8	62,000	62,000	96.5834%	59,882	59,882	0	59,882
AY+9	0	0	0	0	0	0	0
AY+10	0	0	0	0	0	0	0
AY+11	0	0	0	0	0	0	0
AY+12	0	0	0	0	0	0	0
AY+13	0	0	0	0	0	0	0
AY+14	0	0	0	0	0	0	0
AY+15	0	0	0	0	0	0	0
Total	620,000	0	620,000	592,716	592,716	0	592,716
Undiscounted Reserves							
Line of Insurance Comm Multi Peril	Actuarial Estimate of Recoverable Books of Company @ 12/31/89	Recognized on Books of Company @ 12/31/89	Not Recognized on Books of Company @ 12/31/89	Discount Factor @ 12/31/89	Actuarial Estimate of Recoverable Books of Company @ 12/31/89	Recognized on Books of Company @ 12/31/89	Not Recognized on Books of Company @ 12/31/89
AY+0	6,007,000	6,007,000	87.6120%	5,262,853	5,262,853	0	5,262,853
AY+1	4,400,000	4,400,000	85.0222%	3,740,977	3,740,977	0	3,740,977
AY+2	2,464,000	2,464,000	85.9497%	2,117,801	2,117,801	0	2,117,801
AY+3	1,478,000	1,478,000	85.9857%	1,270,859	1,270,859	0	1,270,859
AY+4	627,000	627,000	86.1380%	540,085	540,085	0	540,085
AY+5	434,000	434,000	84.1235%	365,096	365,096	0	365,096
AY+6	180,000	180,000	83.9694%	151,127	151,127	0	151,127
AY+7	54,000	54,000	87.2273%	47,103	47,103	0	47,103
AY+8	139,000	139,000	87.8062%	122,051	122,051	0	122,051
AY+9	0	0	80.7397%	0	0	0	0
AY+10	0	0	92.6060%	0	0	0	0
AY+11	0	0	92.6060%	0	0	0	0
AY+12	0	0	92.6060%	0	0	0	0
AY+13	0	0	92.6060%	0	0	0	0
AY+14	0	0	92.6060%	0	0	0	0
AY+15	0	0	92.6060%	0	0	0	0
Total	15,783,000	0	15,783,000	13,617,960	13,617,960	0	13,617,960

Line of Insurance Fire & Allied	Undiscounted Reserves			Discounted Reserves		
	Actuarial Estimat of Recoverable Books of Compa	Recognized on Books of Compa	Not Recognized Books of Compa	Discount Factor @ 12/31/89	Actuarial Estimat of Recoverable Books of Compa	Recognized on Books of Compa
	@ 12/31/89	@ 12/31/89	@ 12/31/89	@ 12/31/89	@ 12/31/89	@ 12/31/89
AY+0	938,000	93,2650%	874,826	\$0	\$0	\$874,826
AY+1	963,000	92,8552%	894,196	\$0	\$0	\$894,196
AY+2	686,000	96,5834%	662,562	\$0	\$0	\$662,562
AY+3	239,000	96,5834%	230,834	\$0	\$0	\$230,834
AY+4	70,000	96,5834%	67,608	\$0	\$0	\$67,608
AY+5	70,000	96,5834%	67,608	\$0	\$0	\$67,608
AY+6	99,000	96,5834%	95,618	\$0	\$0	\$95,618
AY+7	10,000	96,5834%	9,658	\$0	\$0	\$9,658
AY+8	36,000	96,5834%	34,770	\$0	\$0	\$34,770
AY+9	0	0	0	\$0	\$0	\$0
AY+10	0	0	0	\$0	\$0	\$0
AY+11	0	0	0	\$0	\$0	\$0
AY+12	0	0	0	\$0	\$0	\$0
AY+13	0	0	0	\$0	\$0	\$0
AY+14	0	0	0	\$0	\$0	\$0
AY+15	0	0	0	\$0	\$0	\$0
Total	3,111,000	0	3,111,000	2,937,680	0	2,937,680.416

Workers Comp

Accident Year	Direct	Ceded	Assumed NCICI Pool	Northwest Amts	Net Recoverable
1989	36,210,000	0	13,743,925	2,028,801	51,982,726
1988	34,120,000	0	13,828,895	1,600,104	49,548,999
1987	30,825,000	0	11,162,303	944,110	42,931,413
1986	16,583,000	0	5,160,557	541,270	22,284,827
1985	8,444,000	0	1,833,579	134,843	10,412,422
1984	3,340,000	0	805,808	2,874	4,148,682
1983	1,965,000	0	583,156	77	2,548,233
1982	775,000	0	462,922		1,237,922
1981	0	0	627,852		627,852
Prior	2,034,000	0	1,651,248		3,685,248
Total	134,296,000	0	49,860,245	5,252,079	189,408,324

Auto Physical Damage

Accident Year	Direct	Ceded	Assumed MassCAR	Assumed Other	Net Recoverable
1989	51,026,000	0	8,141,281	55,115	59,222,396
1988	11,285,000	0	9,690,185	18,152	20,993,337
1987	4,099,000	0	3,003,827	10,998	7,113,825
1986	1,494,000	0	802,244	36	2,296,280
1985	753,000			21	753,021
1984	285,000			7	285,007
1983	116,000			8	116,008
1982	51,000			3	51,003
Prior	195,000			0	195,000
Total	69,304,000	0	21,637,537	84,340	91,025,877
Auto Liability					
Accident Year	Direct	Ceded	Assumed MassCAR	Assumed Other	Net Recoverable
1989	7,737,000	0	1,097,051	31,156	8,865,207
1988	5,532,000	0	2,329,794	6,624	7,868,418
1987	2,332,000	0	871,842	2,633	3,206,475
1986	1,200,000	0	204,427	1,795	1,406,222
1985	721,000	0	66,837	563	788,400
1984	166,000	0	50,538	364	216,902
1983	239,000	0	133,566	1	372,567
1982	22,000	0	99,716	0	121,716
1981	0	0	63,158	0	63,158
Prior	249,000	0	20,283	0	269,283
Total	18,198,000	0	4,937,212	43,136	23,178,348

Form 886-A	EXPLANATION OF ITEMS	Schedule No. or Exhibit
Name of Taxpayer Liberty Mutual Insurance Pool	Year/Period Ended 1988 - 1990	

which estimated salvage recoverable was not separately taken into account is a change in method of accounting for which taxpayer must receive approval by the Commissioner.

Government's Position:

The government contends, pursuant to Treas. Reg. 1.832-4(f)(3)(iii), that any taxpayer that "claims the special deduction is precluded from also claiming the section 481 adjustment..." The government also maintains that once a company has taken the special deduction any change in method of computing unpaid losses can only be done so with the consent of the Commissioner. This position is based on section 4.04 of Rev. Proc. 92-77.

Conclusion:

Accordingly, the government is denying the taxpayer request for affirmative adjustment to change from claiming the Special Deduction and the Fresh Start to claiming only the Fresh Start.